

GENERAL INFORMATION

The Community Reinvestment Act (“CRA”) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of Welcome State Bank, Welcome, Minnesota, prepared by the Federal Reserve Bank of Minneapolis, the institution's supervisory agency, as of April 1, 1997. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION'S CRA RATING: This institution is rated “Satisfactory.”

There are a number of factors that support this bank’s satisfactory rating. First, the bank maintains a high loan-to-deposit ratio. Second, the bank has made a significant number of its loans within its assessment area. Finally, based on an analysis of the bank’s loans, the bank lends to borrowers of different income levels and to small farms and businesses.

DESCRIPTION OF INSTITUTION

The bank is able to meet the credit needs of the communities in its assessment area effectively. At its last evaluation for CRA, the bank received a satisfactory rating. The bank operates a full-service office in Welcome, Minnesota, which is open from 8:30 a.m. to 3:00 p.m. Monday through Thursday and 8:30 a.m. to 6:00 p.m. on Friday. The bank has not opened or closed any offices since the last evaluation.

According to the December 31, 1996, Report of Condition ("ROC"), the bank has total assets of approximately \$13.2 million. Since September 30, 1995, the bank's total assets have increased approximately \$.4 million, or 3%. During that time, the bank's loans and deposits remained relatively stable; the bank's net loans decreased by a modest \$60,000 while total deposits increased by approximately \$.7 million. The bank is primarily a small farm and business lender. Agricultural loans are the largest percentage of the portfolio at 55%. The remainder of the portfolio is approximately 20% commercial, 15% consumer, and 10% consumer real estate and other loans. The composition of the loan portfolio reflects the agricultural nature of the area the bank serves. The quarterly average net loan-to-deposit ratio for the bank has been 77% since the previous CRA evaluation.

The bank offers a variety of loan products to help meet the credit needs of residents and businesses of its assessment area. It extends agricultural, commercial, and consumer loans and originates residential real estate loans that it sells to a correspondent bank. The bank also offers credit cards and participates in government-sponsored loan programs, including those offered by the Minnesota Housing Finance Agency, the Small Business Administration, and the Farm Service Agency, formerly known as the Farmers Home Administration.

DESCRIPTION OF WELCOME STATE BANK'S ASSESSMENT AREA

The bank defines its assessment area as Martin County, Minnesota. The assessment area consists of six block numbering areas ("BNA"): 9901, 9902, 9903, 9904, 9905, and 9906, all of which are classified middle-income. The bank is located in BNA 9902. Welcome is located in south-central Minnesota approximately nine miles west of Fairmont, Minnesota, and approximately 130 miles southwest of Minneapolis-St. Paul, Minnesota. Rochester, Minnesota, is approximately 115 miles to the east. Welcome is a small, rural community with a population of 790. Fairmont is the county seat and the largest community in the assessment area. According to 1994 estimated population data compiled by the Minnesota Department of Trade and Economic Development, Fairmont's population is approximately 11,350 and Martin County's population is approximately 22,842. Other towns within the assessment area include the small farming communities of Sherburn, Trimont, Truman, Northrop, and Granada, Minnesota.

CRA divides income levels into four categories: low, moderate, middle, and upper. Because the bank's assessment area is not in a metropolitan statistical area, the categorization of a borrower or BNA's income is determined relative to the statewide nonmetropolitan median family income. Low-income individuals have incomes of less than 50% of the statewide nonmetropolitan median family income, while moderate-income individuals have incomes of at least 50% but less than 80% of this amount. The regulation defines a middle-income person as one with an income of at least 80% but less than 120% of the statewide nonmetropolitan median income. An individual with an income that is 120% or more of the statewide nonmetropolitan median income is considered an upper-income person. BNAs are classified using similar categories based on the level of the median family income in the geography.

As previously mentioned, all six BNAs in the assessment area are classified middle income. According to 1990 census data, the assessment area's median family income is \$29,856 while the median household income is \$24,417. These figures are slightly above the median family and household incomes for nonmetropolitan areas in Minnesota of \$28,933 and \$23,627, respectively. Of the 9,157 households in the assessment area, approximately 22% are low income, 16% are moderate income, 20% are middle income, and 42% are upper income. Approximately 13% of the households and 9% of the families have incomes below the poverty level.

Examiners made a community contact with a local economic development official who is familiar with the economic characteristics and credit needs of the assessment area. Information obtained from this individual and bank management was used in evaluating the bank's CRA performance. According to the contact and bank management, the current economic health of Martin County has improved and is now stable. According to 1994 U.S. Bureau of Labor Statistics data, Martin County's annual average unemployment rate is 4.7%.

Martin County's economy continues to be agriculturally driven and closely follows the national agricultural economy. Livestock operations are mostly geared toward hog production, although there are a few feeder-cattle producers in the county. Corn and soy beans are the major grain crops in the area. Currently, hog and grain prices are good, and the feeder-cattle market is recovering from a period of low beef prices.

According to bank management, Welcome's major nonfarm employer, a small manufacturing company, is relocating and several local jobs will be eliminated. However, this situation is mitigated somewhat because the community has been successful in attracting a small computer software company that has developed an automatic livestock feeding-control system and proprietary software. This company will occupy the building being vacated by the relocating manufacturing company. Welcome has developed into a bedroom community for nearby Fairmont. According to bank management, there is little available housing. Few new homes are built, and existing houses are not offered for sale very often.

Fairmont has a fairly diversified business economy for a smaller community. In addition to many agriculturally-related businesses and service-industry providers, Fairmont boasts a number of small manufacturing companies. Major employers include a specialty frozen foods producer that employs 450 workers; a calibrated weight scales manufacturer that employs 350 people; an automotive and apparel trimmings manufacturer that employs 200; and a local community hospital with 279 doctors, nurses, and laboratory technicians, which is affiliated with the Mayo Clinic in Rochester, Minnesota.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank has done a satisfactory job of meeting the credit needs of its assessment area. Much of the analysis on the following pages was based on a statistical sample of 66 consumer loans and 60 agricultural and commercial loans originated in the 12 months preceding the evaluation. The criteria discussed below were reviewed in determining this rating.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's loan-to-deposit ratio exceeds the standards for satisfactory performance based on loan demand, the lack of unmet credit needs, its consistently high level, its comparison to its local competitors, the bank's Uniform Bank Performance Report ("UBPR") ranking, and the level of loans relative to similar-sized institutions throughout Minnesota.

Since the previous evaluation, the quarterly average of the bank's net loan-to-deposit ratio is 77%. Including secondary market loan sales would increase the bank's quarterly average net loan-to-deposit ratio a few percentage points. According to the December 31, 1996, ROC, the bank's loan-to-deposit ratio was 76%. The following chart, based on quarterly ROC data, shows that the bank's ratio has been consistently high since the last evaluation. The fluctuations in deposits in the fourth quarter of 1995 and third and fourth quarters of 1996 were caused by temporary deposits from the local school district.

DATE	NET LOANS (In thousands)	DEPOSITS (In thousands)	NET LOAN -TO- DEPOSIT RATIO
December 31, 1996	\$9,185	\$12,073	76%
September 30, 1996	\$9,728	\$12,248	79%
June 30, 1996	\$9,328	\$11,342	82%
March 31, 1996	\$8,476	\$11,476	74%
December 31, 1995	\$8,618	\$12,014	72%
September 30, 1995	\$9,245	\$11,396	81%

The chart also shows the fluctuations in loan volume as a result of the advances and paydowns on agricultural lines of credit consistent with a loan portfolio that is primarily agricultural. Since the last CRA evaluation, the bank's loan-to-deposit ratio has fluctuated between a high of 82% as of June 30, 1996, and a low of 72% as of December 31, 1995.

According to the December 31, 1996, UBPR, the bank's 76% loan-to-deposit ratio is 15 percentage points higher than its peer group average of 61%. The bank's ratio places it in the 86th percentile compared with its peers. The banking environment in Martin County is fairly competitive. Twelve financial institutions have offices in Martin County; half are located in Fairmont, and half are located in the other small towns in Martin County.

The following chart shows the average net loan-to-deposit ratio for some of the bank's local competitors.

BANK	TOTAL ASSETS (As of December 31, 1996) (In thousands)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
Welcome State Bank Welcome, MN	\$ 13,232	77%
Competitor A	\$ 42,871	75%
Competitor B	\$ 31,063	83%
Competitor C	\$117,340	80%
Competitor D	\$116,664	67%
Competitor E	\$ 23,649	49%

BANK	TOTAL ASSETS (As of December 31, 1996) (In thousands)	QUARTERLY AVERAGE NET LOAN-TO-DEPOSIT RATIO
Competitor F	\$ 33,055	63%
Competitor G	\$ 35,163	80%
Competitor H	\$ 21,747	61%
Competitor I	\$ 10,951	52%

As shown above, the bank's quarterly average net loan-to-deposit ratio compares favorably with the competition, particularly with the ratios of similarly sized competitors. The bank's quarterly average net loan-to-deposit ratio is higher than six of the competitors and lower than three of its competitors. The chart also shows that the bank is the second smallest of those listed. Of the three competitor banks with higher quarterly average loan-to-deposit ratios than Welcome State Bank, two (Competitors B and G) have total assets of more than twice the size of the bank. The third competitor bank (Competitor C) has an asset size nine times larger than Welcome State Bank's asset size. In addition, the December 31, 1996, UBPR indicates that Welcome State Bank's average net loans to assets was 60.4%. The average for all banks in Minnesota with assets of less than \$25 million is 58.6%.

Bank management indicated that the bank in Welcome competes with all of the banks in the assessment area and the level of competition for most loan types is high for a county of just under 23,000 residents. The bank also makes many small-dollar consumer loans, which has had an effect on the loan-to-deposit ratio. Information received from a member of the community contacted during the evaluation did not identify any unmet credit needs. The bank's loan-to-deposit ratio exceeds the standards for satisfactory performance for several reasons: loan demand levels, the lack of unmet credit needs, the bank's consistently high loan-to-deposit ratio, its loan-to-deposit ratio in comparison to its local competitors, its UBPR ranking, and the level of loans relative to similar-sized institutions throughout Minnesota.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

A review of the statistical sample of the loans originated by the bank in the 12 months preceding the evaluation reveals that a significant majority of the loans were made inside the assessment area. The following table shows the percentage of loans within the assessment area based on total number and loan amount in each major loan category.

PERCENTAGE OF LOANS IN THE ASSESSMENT AREA		
Loan Type	Total Number of Loans	Total Amount of Loans
Consumer	88%	81%
Agricultural and Commercial	97%	95%

As the table shows, a significant majority of the bank's loans in the sample were made within the bank's assessment area. Based on the high concentration of lending within the assessment area, the bank exceeds the standards for satisfactory performance in this category.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO BUSINESSES OF DIFFERENT SIZES

The bank's level of lending to individuals of different income levels and to businesses of different sizes meets the standards for satisfactory performance. As discussed, CRA classifies income levels into four categories: low, moderate, middle, and upper. According to 1990 census data, the median household and family incomes for the bank's assessment area are \$24,417 and \$29,856, respectively. Both figures are above the statewide nonmetropolitan median household and family incomes of \$23,627 and \$28,933, respectively.

As previously mentioned, the performance evaluation was based on a statistical sample of 66 consumer loans and 60 agricultural and commercial loans. However, income data was available for only 39% of the consumer loans in the sample. The scarcity of income data made analysis of income distribution for consumer loan borrowers of little value. Because of this fact, the analysis in this section of the evaluation is based on the agricultural and commercial sample.

Small farm and business loans are the bank's primary lending focus. As previously mentioned, approximately 75% of the bank's loan portfolio falls into these categories. All of the 58 agricultural and commercial loans in the bank's assessment area were to borrowers with gross annual revenues of \$1 million or less. In addition, 90% of the loans were for amounts less than or equal to \$100,000. The remaining 10% of the loans were for more than \$100,000 but less than \$250,000. Given that agricultural and commercial loans make up the largest percentage of the loan portfolio, the size and volume of the loans appear reasonable.

Overall, the bank's emphasis on lending to small farms and businesses meets the standards for satisfactory performance. This conclusion is based on the available data for small farm and business lending. The lack of income data for consumer loans did not allow analysis of that loan category and precluded a higher rating in this category.

GEOGRAPHIC DISTRIBUTION OF LOANS

Based on 1990 census data, all BNAs in the assessment area are classified middle income. Community contacts indicated that low- and moderate-income residents are not concentrated in any areas but are dispersed throughout the assessment area. Therefore, an analysis of consumer and agricultural and commercial loans by differing income geographies would not be meaningful.

GENERAL

The evaluation did not reveal any violations of the substantive or technical provisions of the fair lending and fair housing laws and regulations. In addition, the bank has not received any CRA-related complaints since the previous evaluation.

PUBLIC DISCLOSURE

April 1, 1997
Date of Evaluation

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Welcome State Bank
Name of Depository Institution

092764400000
Identification Number of Institution

Welcome, Minnesota
Address of Institution

Federal Reserve Bank of Minneapolis
250 Marquette Avenue
Minneapolis, Minnesota 55401-2171

NOTE: This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.